RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Nov. 23, 1994 **LETTER 1161**

REVOLUTION: Well, the nation's voters gave Mr. Clinton and the Democrats and the liberals a resounding kick in their respective rear-ends (groins is more like it). So we now have what amounts to a "lame duck" President, a shell-shocked President who has been reduced to saying, "Yes," or, "No," to whatever bills come out of Congress. Will the Republicans make a difference? Will they live up to their promises? We'll see. The **one thing** I think they should do (and it was not mentioned in the "Contract for America") would be to institute a **national sales tax** or a **flat tax**, thereby ridding the nation of the current disgraceful, inefficient tax system (tax industry, I call it). Politicians (Republicans) who read this Letter -- c'mon, instead of juggling around the old tax system, let's make a fundamental change; let's do something that will make a **real difference** for the nation.

As far as the Republican promise ("The Contract") to lower taxes and at the same time shrink the deficit, how's that going to work? Of course, it could work if they're willing to drastically reduce spending and entitlements. As for a Balanced Budget Amendment, how's that going to work? Of course, it could work if they're willing to accept drastic deflation. Listen, I voted Republican, but I also deal in reality. I can also add and subtract. By the way, I note that over the last 12 months (despite Clinton's deceptive boasts) we've **added $288 billion to the national debt** -- that's deficit reduction? Who's kidding whom?

THE PICTURE: Slowly, slowly, ever so slowly, a few investors are beginning to accept the bear market thesis. Notice that I say "investors." I base this observation (strangely enough) on the rate of subscriptions coming in to this office. Over the past few weeks, the number of incoming subscriptions has jumped dramatically. I know from past experience that when this happens sophisticated investors (which is what my subscribers tend to be) are beginning to believe the bear market story. But wait, I said "sophisticated investors." What about the millions of "amateurs" (i.e., the public) who continue to be faithful stock buyers? I'm talking about the Great American Public who hold an astounding $2 trillion in mutual funds. They are the ones who believe that the past offers a golden blueprint for the future. They're the ones who are convinced that all you have to do is buy mutual funds (right, with stocks at their most over-valued levels in history) and sit with those funds -- and, lo and behold, you'll retire a millionaire at age 60. They are the ones who listen to and believe the "bull market forever" stories as put forth in the newspapers and magazines (and yes, from Wall Street).

So you have to ask yourself, what happens when these people start calling their mutual funds and saying, "Hello Fidelity, I'd like to switch my equity fund into your money market fund. Er. How long will that take?"

Remember, this bull market has been built on an edifice of 20 years of an ever-higher stock market. Remember, that in the last 12 years there's never been a Dow low that broke below a preceding year's Dow low. Remember, it's been four years since the Dow has posted as much as a 10% decline within a given calendar year (this has never happened before!).

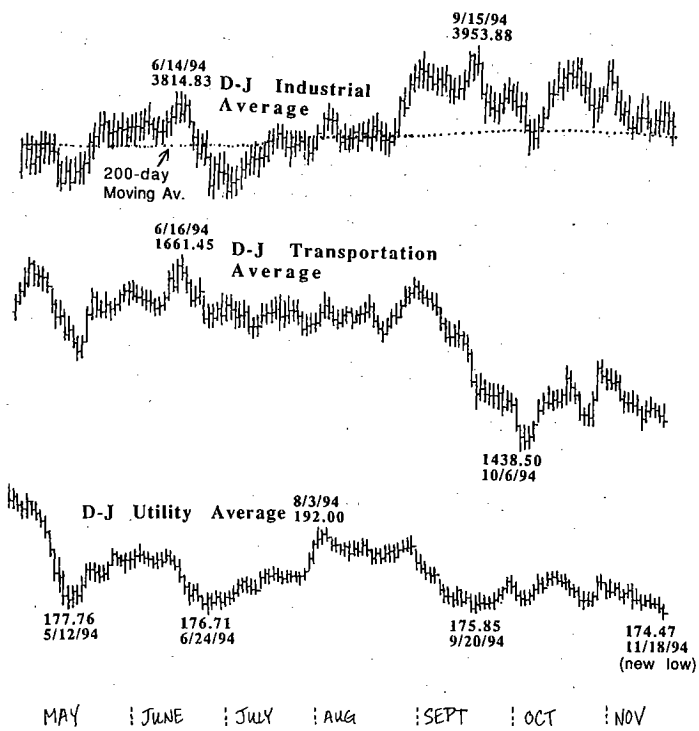
Almost two generations of the public has been schooled in the philosophy, *"Buy and hold, you'll be rich when you're old."* Well, I know a lot of old people, and not that many of them are rich. The ones that are rich, most of them, have become rich by inheriting the money or by owning or running their own business. Despite all the hoopla, I don't know many people who have become rich by buying and holding stocks. The trouble is that the "buy and get rich" advice has mostly arrived over the last few years just as the public was rushing into the stock and bond markets with their life's savings in their hands.

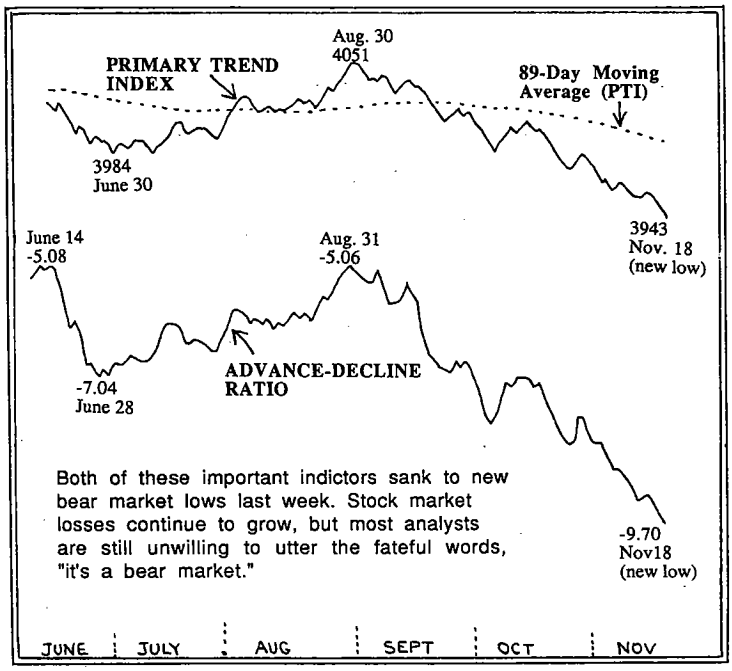
Nov. 11 DJIA 3801.47; PTI 3956; A-D Ratio -9.28
Nov. 4 DJIA 3815.26; PTI 3943; A-D Ratio -9.70
Dow Yield: 2.79%; Dow Price/Earnings: 18.0
Dow 200-day MA: 3790; Dow 30-day MA: 3860
Dow Times Book Value: 3.41; PTI 89-day MA: 3998
Percentage of Undervalued Blue-chips: 11%
Dow Low Risk Buy Index: +23; Gold-PTI: 826
Gold 200-day MA: 384.78

Question: Where were the "buy and hold and get rich" advisors at the great stock market bottoms of 1949 or 1974 or 1982? Unfortunately, most of them were working someplace else or they were advising their clients, "Get into T-bills and hold onto those babies for dear life. "

Yes, the stock market is a **fair game.** The only problem is that the public doesn't understand the rules, and when they do it's usually too late. Too late for what? Too late to make real money in a bull market, and too late to avoid costly losses in a bear market.

So what we have now is the public in the markets up to its collective neck. They're heavily in the market via stocks, bonds and mutual funds. As I said, the stock market is a fair game, and we'll just have to wait to see how all this turns out. I'm predicting that it's not going to turn out pleasantly. I don't see how it can with the bear just waking up after 20 long years of hibernation.





CURRENT MARKET STATUS: In the last Letter I wrote that there is still one glitch in the bear market case. The glitch is that the Dow has refused to follow the rest of the market down. Thus, we have a technical stand-off between the Dow and the rest of the market (i.e., the majority of stocks).

Ultimately, it's up to the Dow to break the impasse. How to do it? One way is for the Dow to rally to a new record high, a high that would lack confirmation by the Transports, the Utilities, the Primary Trend Index, the advance-decline ratio and almost everything else. Such a flagrant non-confirmation would set the stage for a major bear market decline into 1995.

A second resolution would be for the Dow to simply turn down and follow the A-D and the PTI to lower levels. I put the odds for either of these resolutions at 50/50. Take your choice, but the operative thought is that either way -- it's still a bear market.

Another thought, and I talked about this in the last Letter. We must realize that both the A-D ratio and the PTI topped out last February 2. Thus, the current erratic "down-leg" of the bear market has been in force for nine months, which is a fairly long time. Considering the time element of the February-to-November decline, it would "seem" that some kind of a rally is overdue. But a primary bear market can become over-sold and **stay over-sold for extended periods of time**. In fact, veteran traders know that when an over-sold market remains over-sold for weeks on end -- watch out (it's another confirmation that a bear market is in force).

For optimists still looking for the upside, the two important upside Dow levels are the September 15 high of **3953.88** and the January 31 record peak of **3978.36.** If the Dow was to rally above either of those highs, we would have a veritable cluster of serious non-confirmations (including a non-confirmation by the Dow advance-decline line itself).

SUNDRY COMMENTS: Three Steps: The late, great Edson Gould codified the "Three Steps and a Stumble Rule," which is actually an observation that tells us that when the Fed raises any of its three prerogatives (stock margins, bank reserves, discount rate) three times in a row, there's trouble ahead for the stock market. The third Fed boost arrived on Nov. 15, and this time it arrived within an ongoing bear market. Here's the record (courtesy of *Investor's Digest*, 3471 N. Federal, Ft. Lauderdale, FL 33306).

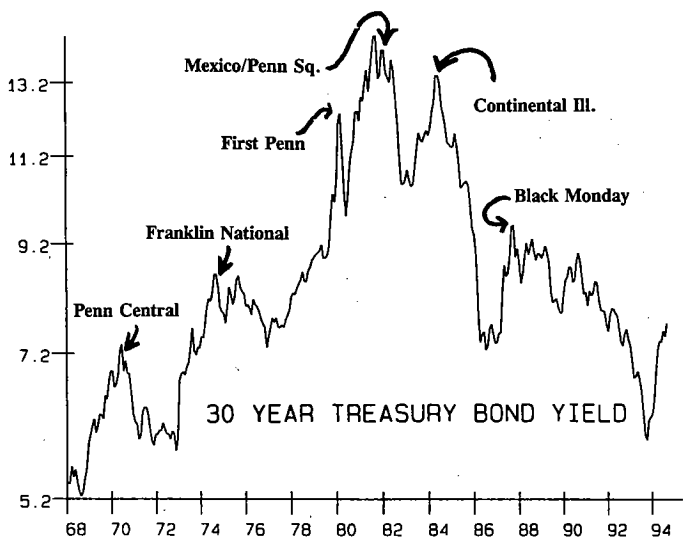
DJIA After "Three Steps and a Stumble" Sell Signals

Sell Signal	Subsequent Drop	Duration of Drop in Days
Nov. 3, 1919	– 47%	660
July 13, 1928	– 4%	488
May 1, 1937	– 43%	334
Jan. 2, 1946	– 15%	500
Aug. 13, 1948	– 10%	304
Sept. 9, 1955	– 12%	774
Mar. 6, 1959	– 7%	599
Dec. 6, 1965	– 21%	305
Apr. 19, 1968	– 30%	767
May 4, 1973	– 39%	581
Jan. 9, 1978	– 5%	50
Dec. 5, 1980	– 19%	615
Feb. 24, 1989	– 5%	594
Average:	– 19%	506

High-Lows: During the early '90s (mainly in an effort to reliquefy the banks) the Fed lowered rates in an extraordinary series of 17 steps. As rates declined almost every bond and rate-sensitive stock took off on the upside (action which produced a continuing parade of new 52-week highs on the NYSE).

But this year the shoe was on the other foot. Rates have been rising, and under the pressure of rising rates, bonds and interest-sensitive stocks have declined. This phenomenon is producing **hundreds of daily new lows** on the NYSE. The preponderance of daily new lows has been giving the stock market a "sloppy" or "heavy" look.

Ed Hyman of *ISI* has published this fascinating chart showing, "At **every peak** in bond yields, there has been a **financial crisis.** So far in 1994," notes Ed, "there have been financial strains (the derivative problem, the dollar/yen decline, etc.) but no clear crisis signaling that rising rates have had an impact." **Russell comment:** We're nearing or at another peak, so let's watch it.



INVESTMENT POSITION: The bear's in the box, and losses have been accumulating. The worst damage has occurred in the bond market, but the stock market has been far from immune. The dollar has been sick, but it may now be oversold enough to hold for a while. Meanwhile, gold floats around in a tight trading range.

What to do? At this point -- nothing. We're in cash; let's stay there.

Barron's (Nov. 14) includes an article which notes that many closed-end muni funds are now selling at substantial discounts

from net asset value and therefore may be bargains. They may be, if interest rates have bottomed. But the problem with closed-end funds is that they are managed. If management (and there's a charge for management) messes up, then regardless of the trend of bonds you can take a loss. Therefore, if muni bonds are now discounted bargains, I'd rather buy the bonds themselves rather than the funds. When you buy a good bond (AA rated or better), you know you'll receive the face value of the bond when it matures. But when you buy a discounted closed-end bond fund, there's no maturity date on the fund and you can never be sure what you'll be getting when you sell it (as many of today's sellers have discovered to their chagrin).

Foolin' around -- on Oct. 26 with the market appearing temporarily oversold I bought 20 December 480 S&P options (cost $6000). I bought them just before that huge 2-day surge. At the end of the two days my options were worth $30,000. And ah yes, I thought the rally would continue for at least a few more days, so I sold four options (which gave me my original money back) and held the rest. A few days later with the market selling off I sold the other 16 options for a total profit of $4,500. I can't complain, because it was a profit. But there's a lesson -- anytime a spec of $6000 turns into $30,000 in two days, take the money and run. The markets seldom let you keep that kind of a "gift," so take it, stupid.

For my subscribers (and never mind my occasional shenanigans) -- stay with cash, money market funds, gold coins. I've been thinking a lot about what will hold up if we get a major deflation. The question I'm asking myself -- if the dollar goes down, what will it go down against, or what will it hold up against? I'll address that question at length in future Letters.

A subscriber called me to say that he has millions of dollars of very long-term profits, and he would hate to sell and pay the taxes -- what should he do? I told him that I could offer no guarantee regarding how big this bear market was fated to be, but he might do one of three things: (1) he could hold all his stocks and simply pray; (2) he could follow correct procedure and sell in three or four steps, with the first sell-level being 458 on the S&P 500, the second being 432; (3) he could follow correct procedure and just sell out completely and watch the show from the sidelines.

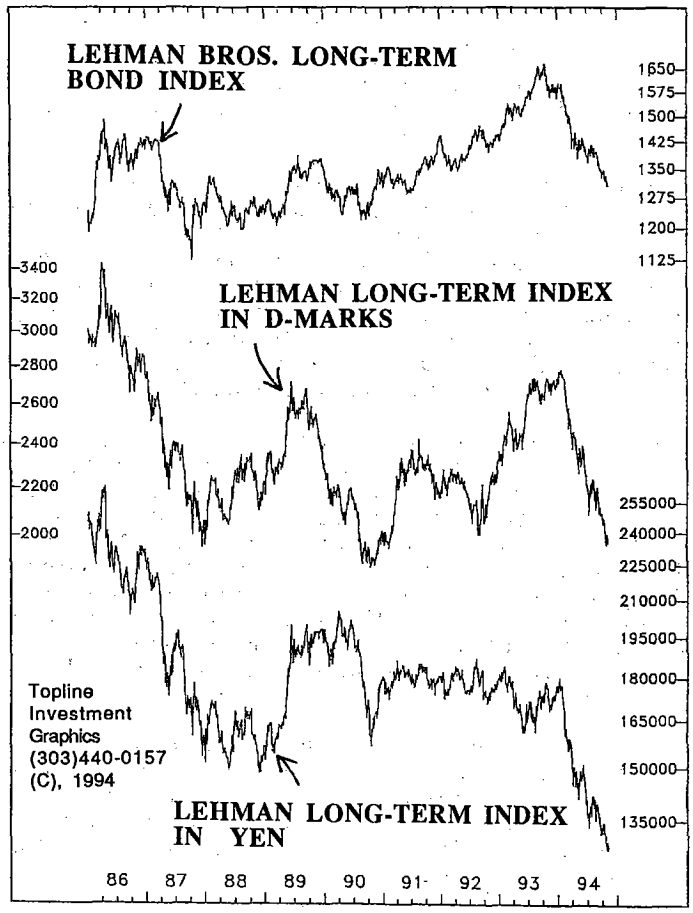
THOUGHTS: Question: Russell, what about the "decennial pattern?" We've never had a down fifth year in any decade in this century. So how could 1995 be a bear market year?

Answer: If a primary bull market is in force then any year, including the fifth year of a decade, will probably be an up year. However, if a primary bear market is in force, the fifth year will probably be down. Ironically, there's been no fifth year in any decade since 1895 in which a primary bear market was in force. The year 1895, however, was an exception, and from September to December of 1895 the market collapsed with the Dow dropping 20% over those last four months.

Another thought: the more a pattern repeats in the stock market, the better the odds that it won't repeat on the next try. Since we have not had a down fifth year since 1895, there is at least a theoretical chance that the pattern will be broken in 1995. In other words, how long can a string of coincidences last?

Statistics: 1905 -- Dow up 38%;1915 -- Dow up 81%; 1925 -- Dow up 30%; 1935 -- Dow up 38%; 1945 -- Dow up 26%; 1955 -- Dow up 20%; 1965 -- Dow up 10%; 1975 -- Dow up 38%; 1985 -- Dow up 27%. 1995 -- Dow ????

Question: What's it like to be a overseas holder of US bonds? Old friend and computer maven John Carder ran this chart off for me on his super-computer. It shows Lehman's Long-Term Bond Index (top item), then Lehman's Index in terms of German marks, and at the bottom Lehman's Index in terms of the Japanese yen (oof!). For example, Japanese holding US long-term bonds since the mid-'80s have seen their "investment" cut in half in value. How long can the Japanese hold? Will they keep buying? You tell me. But this year has been an absolute horror for overseas investors in US securities, particularly bonds.



Question: Will the "new" Republican sweep in the House and Senate change or reverse the primary trend of the market?

Answer: Unfortunately, no. Once the market has discounted the best that can be seen ahead (which is the definition of a bull market top), then there's nowhere for the market to go but down. HOW the market goes down is the great variable. One bear market can literally crash (as per 1937-38), and another can "unwind" in a convoluted series of mini-bull and mini-bear markets before finally collapsing, as per 1966-74. **Each bear market is different,** but the operative concept to keep in mind is that the bear wants to go down (i.e., create losses) while taking the greatest number of stockholders with him.

The most recent "bear market type" action occurred during 1987 and 1990. In both instances we experienced crash action. So crashes are what the public believes constitute bear market action. Consequently, it's crash action that the public is afraid of.

So naturally, that's not the way this bear market is going to work. No, this bear market is going to keep the public "in and losing" by the attrition method. People are going to see their investments go down the drain via slow attrition, rather than by a frightening crash as per 1987.

Remember, the bear will do whatever he has to do to keep people "stupid, happy and losing." The bear's method of choice in this bear market has been **attrition,** slow, tedious attrition.

NOTES & QUOTES: As subscribers have undoubtedly guessed, I was delighted with the election outcome. Newton Leroy Gingrich, Robert Dole and Dick Armey are our new leaders. It suits me. Newt's "Contract with America," it sounds good, and Newt's evidently deadly serious about it. Newt calls Clinton and his bunch the "left-wing elite," and the "enemy of normal Americans." He won't get any argument from me -- I can't wait to get both Clintons out of Washington, and I would guess that top

Democrats are thinking about alternative choices for their presidential candidate in '96.

Dick Armey (R-TX), new House majority leader and head of the Tax-Writing Committee, has been talking about a **flat tax.** So has Bill Archer (R-TX), new chairman of the House Ways and Means Committee. Three cheers for Texas.

One facet of the election was amazing, highly significant and not talked about: **men** voted 54% Republican, 46% Democrat. But get this -- whites voted 58% Republican, 42% Democrat. But blacks voted 12% Republican, 88% Democrat. And Latinos voted 30% Republican, 70% Democrat. Result -- white men won both Houses for the Republicans. It was basically white men who were fed up with Clinton and the Democrats. Blacks and Latinos voted overwhelmingly for the Dems. Oh yes, people with family income under $15,000 voted 62% Democrats, 38% Republicans.

The election: here's the way the London *Economist* described the fiasco: "It was hard to imagine a worse picture. For months Bill Clinton had languished in a political desert: health-care reform dead, his crime bill mugged, welfare reform deferred. And this was in a Congress ostensibly on his side . . . Incumbents will always argue that the verdict was not universal. But Mr. Clinton should have few doubts. Voters loathed him, finding him unworthy of their confidence or respect. They loathed his party, intrinsically entangled with notions of big spending and big government. Southerners hated him with a particular passion, even though he is one of their own."

Anger: Ironically, maybe the best thing I read about the election came from Rep. Andrews, a New Jersey Democrat writing in the Nov. 10 *WSJ:* "The real source of the middle-class political revolution in this country is this: the great majority of my constituents work half a year to pay their taxes. When you add up what they pay to the government in income taxes, Social Security, state income tax, sales taxes and local property taxes, it's pretty easy to pay between 40% and 50% of your income. So voters are convinced of three things. They are convinced that amount is too high. They are convinced that the government does an atrocious job of managing their money at all levels and particularly in Washington. And they are convinced that the re-election machine for incumbent politicians very much depends on their continuing to take a large portion of their income and dispersing it as largesse to various groups who will then support them with campaign contributions. In my opinion, the voters are absolutely right . . . Bill Clinton and the Democratic party had an historic opportunity to seize the moment in 1993, and change the landscape of American politics for the next 30 or 40 years. The administration has forfeited that opportunity." And this from a Democrat!

* *

Over the weekend I ran a computer print-out of all my subscribers. And I was really surprised at the geographical distribution. When I first started writing Dow Theory Letters roughly 75% of my subscribers came from five states -- New York, Texas, Florida, Illinois and California (which was basically where the money was in those days). But through the years geographical distribution has changed radically. Although those five states are still big, subscribers now come from all 50 states -- and increasingly from all over the globe from Taiwan to France, from S. Africa to Canada (a surprisingly large number of Canadians).

As a result, many readers depend to some extent on these *Letters* to give them a sense of what's happening both in the US and around the world. In fact, many sophisticated investors tell me that they read the "Notes & Quotes" section first.

Frankly, I started the Notes section many years ago because I love the news. I read 12 newspapers a day and 25 magazines a week, and I wanted to relate to subscribers a few of the items or ideas that I felt were important (after all, how could I let all my reading time just "go down the drain"). So that's how I got started with "Notes & Quotes," and so far subscribers appear to like this section.

By the way, I'm well aware that literally thousands of *Dow Theory Letters* are run off by various brokerage houses and distributed free to clients (many public and corporate libraries also subscribe to the Letters). The good news is that this gives me a lot of readers. The bad news is that there are a lot of readers out there that never pay me for my efforts. But I believe in Karma. And every few days or so I get a subscription from some one who writes, "I've been reading you for 14 years at ---- Brokers in Chicago, but now I'm moving to Texas, so here's my belated subscription, and thanks for all that free info." So I guess in the end, everything evens out.

* *

Help! I don't think I've ever been besieged by such a mass of "buy" letters, one-time offers, special coupons and assorted "bargains" in the mail. I mean it's wild -- retail catalogues, three, four or five every day, "Last Chance to Subscribe at These Fabulous Rates" from I don't know how many magazines, "Special Sale" ads, penny-saver magazines, "Congratulations, You've Won Our Contest" letters. What's happening? Is industry getting desperate or is mail order extremely profitable or is there something new in the air? I don't know, but my mail box is stuffed every day.

As for *Dow Theory Letters,* I used to advertise in *Barron's,* did it steadily for 32 straight years. But I dropped *Barron's* a few years ago following their umpteenth boost in advertising rates (even though their circulation was sliding). Now I use direct mail only, and I'm pretty conservative with that. In the mean time, computers have become one of my best friends. The ladies in my office can process a subscription in 10% of the time it used to take -- and thanks to Apple and IBM for that.

* *

In his latest report, ol' buddy Harry Schultz (resident of Monaco and traveler to almost every nation on the planet) laments the loss of a slew of advisory letter-writers including Vern Myers, George Schaefer, Adrian McCabe, Ham Bolton, Garfield Drew, Sedge Coppock, Johnny Johnson, Bob Gross, the Hasbroucks, Sam Coslow, Don Hoppe, Jim Sibbet, Don McShane. (And I could name a few more such as mentor James Hughes, from whom I learned about the A-D ratio, Edson Gould, Robert Rhea, and well, why go on?) Now there are **only four** of us old timers left, Harry Schultz, Jim Dines, Joe Granville and myself. The first three started their reports in the early '60s, and I guess I'm the only one out of the '50s writers still around. But listen, the last thing I'd want to do is retire -- I'd be bored to death in about one week.

* *

Oh yeah, I can't believe it, but I've beaten the system. I'm talking about the Social Security system. I've been paying that darn Social Security payroll tax for over half a century. Hah, the bastards thought they had me. They thought they'd never have to pay off. Keep working, sucker, keep making a living, and we'll cut you out -- that is, unless you can make it to age 70. Well, I made it to 70, and I'm still working. So on Nov. 4 I got my first Social Security check. Of course, shortly they'll probably figure out a way to push the age limit to 80 years or 90 years, but right now they're giving me back a few of the hard-earned bucks I put into this Ponzi system. Yeah, I beat the system. Of course, I'm still paying the Social Security tax.

* *

Standard & Poor's has been in the market index business for about 70 years (Dow Jones has been in the business for almost 100 years). The index business is a very competitive affair. Frank Russell Co. of Tacoma, Washington, publishes a few widely-watched indices. One of these is the Russell 2000 -- it's one of the standards for small-growth investing. The 2000 represents the smallest two-thirds of the Russell 3000. The 3000 is an index which covers 98 percent of the market value of all issues traded in the US.

S&P has now come out with its new **SmallCap 600,** an index which will compete with the Russell 2000. S&P says that the 600 includes stocks "chosen for their market size, liquidity, and industry group representation." Meanwhile, the Russell company hopes that its 3000 index will provide serious competition for the very widely-watched S&P 500. As I said, this index business is very competitive.

* *

Oops: Inadvertently, our government has let it slip out that its total spy bill is around $28 billion (that's billion). This amount was supposed to be a secret, but wouldn't you know -- by accident the amount was put into the public record via the House Defense Appropriations subcommittee (a typical government screwup). The Pentagon intelligence service asked for $13.2 billion, and the CIA asked for a just $3.1 billion while the Army, Navy and Air Force asked for $10.4 billion for their tactical intelligence activities. So it's $28 billion for US intelligence work. Gosh, that sounds like a lot, but listen, our guys and gals have got to know what's going on out there.

* *

The Peg? An article in London's *Financial Times* states that Moscow is talking with the IMF of a plan to peg the ruble to the dollar. I guess that's better than nothing, but I don't know -- the dollar is a pretty dicey currency these days.

* *

Is Fed chief Alan Greenspan a traitor to his original beliefs? You have to wonder. This is a paragraph from Alan's 1960s writings: *"The abandonment of the gold standard made it possible for the welfare state to use the backing system as a means to an unlimited expansion of credit. They have created paper reserves in the form of government bonds which -- through a complex series of steps -- the banks accept in place of tangible assets and treat as if they were an actual deposit -- i.e., as the equivalent of what was formerly a deposit of gold."* **Russell comment:** You have to wonder how anyone who wrote this could take a job as head of the Federal Reserve. But listen, don't they say the Fed-head is the second most powerful job in America? And power, says Henry Kissinger, is the most powerful aphrodisiac.

BOOK: Is book value of any use in appraising stocks? I believe it is. Gerry Weiss of La Jolla's *Investment Quality Trends* writes, "Theoretically, book value is the bottom line, dollar amount available to shareholders if all assets of the company were sold and after all debts were paid. The remainder then would be divided among the company's shareholders and typically is quoted as book value, per share of common stock."

Gerry goes on, "Today, with the market in historically overvalued territory, the ratio of price to book value for the D-J Industrial Average is the highest in history, more than 340%. Among the 350 stocks listed in *IQ Trends,* only six blue chip stocks, less than 2% of the total, are priced below book value. An additional 21 stocks, 6% of our total, are priced within 30% of the company's book value. These figures confirm the overvalued condition of the stock market. Although book value figures do not make pleasant reading at the moment, they do make important reading for enlightened investors."

* *

Two new books about President Clinton have just been published. They are, *"Highwire, From the Backroads to the Beltway, the Education of Bill Clinton",* by John Brummett, and, *"On the Edge, the Clinton Presidency,"* by Elizabeth Drew. The *NY Times* (Nov. 4) reviewed both books; here's a few telling paragraphs from the review. "In their own fashion, however, both books offer disturbing and remarkably similar portraits of Mr. Clinton as an indecisive, emotionally-needy and congenitally disorganized President, presiding over a chaotic and crisis-driven White House. Ms. Drew argues that each crisis has 'undermined his position further', and that his presidency has become a 'blur,' while Mr. Brummett characterizes Mr. Clinton's political career as 'an action-adventure story' with a familiar pattern: 'Start out poorly, walk the highwire, rally frantically.'"

What in sum, do Ms. Drew and Mr. Brummett think of the prospects for the rest of the Clinton Presidency? Ms. Drew sounds pessimistic: "That the strength of his Presidency rested almost entirely on legislative achievements -- not on a strong public affection for him, or even respect for him, or an ideological identification with him -- put his Presidency at a constant risk. This shaky base could cave in from under him if he stopped having legislative successes -- but it was the only base available to him."

Russell comment: As far as any more "legislative successes," forget it, there won't be any. The job of the new Congress is to undo some of Clinton's successes, such as his monster tax boost.

* *

Everybody is asking the question -- if things are so marvelous in America, why is the population so frightened or angry? This cartoon goes a long way towards providing the answer:

WHY IS THE AMERICAN PUBLIC SO CRANKY ABOUT THE ECONOMY THESE DAYS, ANYWAY? AFTER ALL, A MULTITUDE OF PUNDITS INSIST THAT THINGS ARE GREAT!
AND WE HAVE STATISTICS TO PROVE IT!
NOT TO MENTION COLORFUL CHARTS!
WELL, THIS IS JUST A CRAZY GUESS -- BUT MAYBE THE PUBLIC HAS BEGUN TO SUSPECT THAT THE EXPERTS HAVE A VERY PECULIAR IDEA OF WHAT CONSTITUTES GOOD ECONOMIC NEWS...
--AND GIGANTICO STOCK SOARED TODAY AFTER 17,000 EMPLOYEES WERE --AH-- DOWNSIZED! INVESTORS MADE A BUNDLE!
HEY, THAT'S TERRIFIC!
GRRR...
OR PERHAPS THIS SENSE OF UNEASE CAN BE TRACED TO THE FACT THAT MANUFACTURING JOBS ARE DISAPPEARING OVERSEAS AT RECORD RATES...OR THAT THE NATION'S LARGEST EMPLOYER IS NOW A TEMP AGENCY...
GREAT NEWS! THE BOSS SAID I CAN WORK NEXT WEEK, TOO!
GEEZ--I WISH I HAD THAT MUCH JOB SECURITY!
THEN AGAIN, PERHAPS THE AMERICAN PUBLIC IS SIMPLY INSANE.
YES--THAT'S IT! THE ENTIRE COUNTRY IS DELUSIONAL!
IT'S THE ONLY PLAUSIBLE EXPLANATION!
WE'D BETTER GET TO WORK ON SOME CHARTS!
Tom Tomorrow

* *

A book review in last week's *NY Times* about hard times for children during the early part of the century got me to thinking. My first job was in 1939. I worked for the old Postal Telegraph Company, and it was during the Depression. I was 15 at the time. My job was delivering telegrams around NYC. About five of us boys would wait in the telegraph room, and we would take turns delivering telegrams as they were wired in. We were paid ONLY when we went on a delivery, and the pay was 30 cents an hour, plus whatever tip we might get from a customer. We were also paid bus and subway fare (a nickel for bus or subway, plus return fare). Some days there would be only ten or 15 telegrams at our office, so I might make only one or two trips for the day. I would end up the whole day with pay of maybe 50 cents up to a dollar. But it was a job, and there were very few jobs available in 1939. Many years later the Postal Telegraph company fell apart and was merged into Western Union. I was happy to see that company disappear.

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DOLLAR: This from George Magnus, chief economist at S.G Warburg & Co., London: "The dollar is weak because there's a fundamental imbalance between saving and investment in the US. America's problem is one of capital starvation." Says Ulrich Beckmann, senior economist at Deutsche Bank AG in Frankfurt -- in the past the Japanese have been big buyers of US securities, "but they have been burned so much by the falling dollar that they are staying home."

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Do the Carolinas love football? Note this -- the NFL's new Carolina Panthers (an expansion team) don't play their first game until 1995, but already they have sold out almost every seat in their yet-to-be-built stadium, and they are ranking among the top NFL teams in merchandise sold.

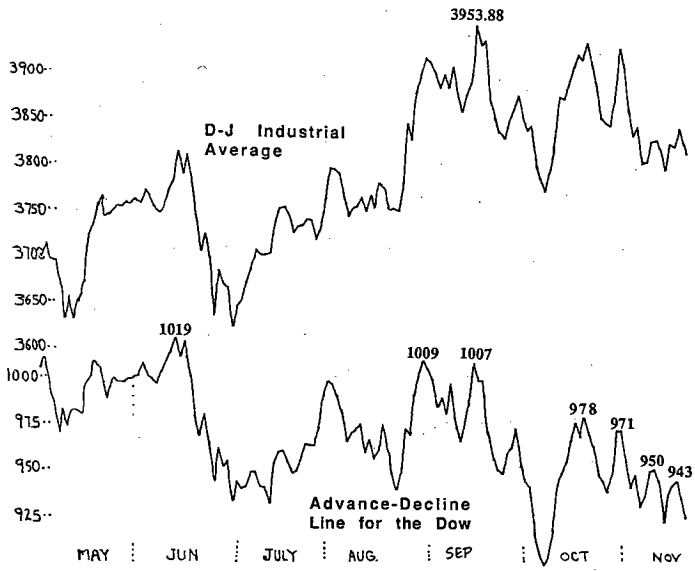
LATE TECHNICAL COMMENTS: Nov. 17 saw **new bear market lows** in the D-J Utility average, and the NYSE Financial Index plus new lows in the NYSE advance-decline ratio and in the PTI (see page 2 chart). Bonds continued weak and near their lows.

I've been putting particular emphasis on the technical situation in the **Dow.** The reason is obvious. The majority of stocks on the NYSE have been heading down, and only the "big" or highly-capitalized averages have been making the situation appear less than disastrous.

Since the Dow has been acting as the "cover-up" Average, it's the Dow that I want to examine. The best insight into the internal structure of the Dow is provided by comparing the Dow with its own advance-decline line (the latter composed of the plurality of advances or declines in the 30 Dow Industrial stocks only).

Note on the chart that we now have **seven declining peaks** in the Dow A-D line, the first recorded on June 14 at 1019 and the most recent struck on Nov. 16 at 943. This can't continue without bringing the Dow down. What this study tells us is that Dow rallies are accompanied by a limited number of Dow issues, while Dow declines are accompanied by an expanding number of Dow issues.

Thus the D-J Industrial Average, the strongest element in the stock market, is showing unmistakable signs of internal weakness. Only a strong rally in the Dow A-D line would reverse this picture. So far, it's not happening.



The advance-decline line for the entire NYSE continues to sag to new lows, accompanied by an expanding number of individual stocks hitting new 52-week lows. This is typical bear market action. Recently, daily new lows have held consistently in the 150 area with many days producing over 200 daily new lows. This is a picture of "stockholders' money going down the drain." Match this with the massive collapse in bonds (long Treasuries down almost 25%) and we're talking about losses in the tens of billions of dollars.

CRYSTAL BALL: I never fail to be amazed at the stock market's ability to look ahead, to discount the future. Remember, the Dow hit its high back on January 31. The A-D ratio recorded its peak a few days later on February 2. That's when the bear market began.

Now, nine months later, we are only beginning to see some of the **reasons** why the far-sighted market turned bearish. Interest rates ratcheting higher, housing starts dropping off, our government at cross-roads with a weak Democratic President and an angry Republican Congress, consumers griping about rising cost-of-living, corporate lay-offs still in the news, the specter of cheap labor and foreign competition looming ever larger, a chronically weak dollar, continuing US budget deficits and continuing current account deficits.

I talked about the **"reverse wealth effect"** in recent Letters. This is the negative effect of security losses on the psyche and buying habits of consumers. With stock and bond losses mounting, I would expect to see this impact on retail sales shortly. It should also hit sales of autos and houses. In short, I expect a recession to begin next year.

GOLD AND DEFLATION: Stocks down, bonds down, the dollar down -- how far down will they go? Unfortunately, no one knows. But I do know this -- there's a total of $15.9 trillion of debt (federal, state, city, corporate, private) in the US. If the bear market continues to batter securities, then a lot of money is going to go down the drain; that process is going to generate **deflation.**

When deflation takes hold, the price of "things" declines. That's what happened during the Depression of the '30s, but there was a difference then. During the '30s the dollar was **king;** the dollar was "as good as gold." The only problem was -- nobody had any dollars.

But this time it's different. This time the dollar is no longer king, and this time the dollar's not as good as gold. Today the dollar has no official connection with gold at all; the dollar is a fiat or paper currency. But we do have one blessing -- we can legally buy gold with our paper dollars.

If the dollar goes down in value, what is it going down against? Over recent years it's been going down against hard currencies such as the D-mark and the Swiss franc. But my feeling is that somewhere ahead people are going to realize that the US debt of $15.9 trillion can't be sustained, can't be supported during a deflationary period. Remember, during a deflation profits and income go down, but it's the profits and the income that are needed to pay off debt.

SO -- what happens when the nation can't pay off the interest on $15.9 trillion in debt? Talk of bankruptcy will abound, and one of the areas of bankruptcy that they'll be talking about (God help us) is the dollar. And that's where the money of last resort comes in. The money of last resort, the base of the monetary pyramid, real money, is GOLD. Yes, it's gold, the "barbaric relic" that every politician hates.

The current situation is ironic yet logical. Gold, the metal, has been holding fairly well within the 375 to 390 range. Not so gold stocks. The gold stocks must sense that something is wrong, and I think what they sense is early hints of deflation. Now this is an important concept -- people hold gold and gold stocks for different reasons. People hold gold as a "store of value." They hold gold because gold is real money, money that they can **possess and hide.** Gold is "last stand money." Gold is undisputed value when everything else is suspect. Sophisticated, knowledgeable investors never sell their gold. They'll sell their house, their car, their business, but they don't sell their gold.

Gold shares are another matter. People buy gold shares because they hope the shares will **appreciate.** They buy gold shares because they know that the shares tend to rise geometrically as or when the metal rises. And right now, gold share holders don't envision any forthcoming rise in gold. So they get discouraged, and unlike the holders of actual gold, the gold share holders sell their stocks.

I think that's what's happening. I don't have room to show my Gold-PTI in this Letter, but suffice it to say that whereas gold has held above 380, the G-PTI has broken to new lows. That's discouraging for holders of gold stocks, and I wouldn't be adverse now to cutting back on gold share holdings. The picture, for the time being, is not a good one.

Please -- two concepts to keep in mind: (1) In a primary bear market **values decline over time** (i.e., time works against the stockholder). (2) In a primary bear market, **everyone loses.** But the **winner in a bear market is the one who loses the least.**

LATE, LATE NOTES: After nine months of decline in the A-D ratio, you'd think the market would be ready to rally. But there's no apparent buying power in this market, and investors are locked in with large across-the-board losses. Are the sagging utilities again leading the way down (as they have ever since the bear market started)?

NEXT MAILING: Dec. 7, 1994